

The irony of alleging that cost-based pricing is unlawfully discriminatory is that up until now, the LECs are the only providers who've been required to charge averaged rates applicable to all customers.⁶² WilTel, the CAPs, the IXC's, and others haven't been restricted in their ability to discriminate between similarly situated customers. For example, the D.C. Circuit has upheld AT&T's ability to do so with its Tariff 12 contracts.⁶³

In 1992, at our request, Quality Strategies surveyed selected customers in Los Angeles and San Francisco who were served by CAPs. They discovered customers who were on the same fiber ring or even in the same building who paid substantially different rates to CAPs for what appeared to be the same service. For example, one customer in the 1000 block of Wilshire Boulevard in Los Angeles reported paying MFS \$250 per month for DSL service with a 2-year commitment. Another customer down the street in the 5600 block paid MFS \$400, also with a 2-year commitment. From this limited survey, it seemed not uncommon for some customers of CAPs to pay 50% more than others for identical service.

We don't contend that such discrimination between customers is unlawful. But it's an irrational state of affairs

⁶² See Local Exchange Carriers' Individual Case Basis DS3 Service Offerings, 4 FCC Rcd. 8634 (1989), on recon., 5 FCC Rcd. 4842 (1990); Local Exchange Carrier' Rates, Terms, and Conditions for Expanded Interconnection for Special Access, CC Docket No. 93-162, Supplemental Designation Order and Order to Show Cause, released May 31, 1994, para. 17.

⁶³ Competitive Telecommunications Assoc. v. FCC, 998 F.2d 1058 (D.C. Cir. 1993).

if it's legal for some providers in a competitive market to do it, and "unlawfully discriminatory" for others.

A few other misstatements are worth correcting. CompTel claims that "any difference between DS1 and DS3 rates beyond the multiplexing costs is necessarily due to discriminatory overhead loadings.... There is a single interoffice network, and all transport offerings -- DS3, DS1, and tandem-switched -- share that network. Consequently, the only justification for pricing a DS1 circuit (used by smaller IXC's) at more than 1/28 the cost of a DS3 circuit is that DS1 circuits must be derived through multiplexing." (CompTel, p. 6.)

In fact the majority of our DS1 circuits are bought by large IXC's, not Tier 3 IXC's. The contention that DS1 prices should be based solely on interoffice network costs is also wrong. It ignores the loop costs associated with DS1 circuits. Finally, CompTel disregards the mix of technology in our interoffice network. In Docket 91-213, the Commission decided not to mandate any fixed DS3:DS1 rate relationship, in part because DS1 costs reflect a technology mix of copper, fiber, and microwave, while DS3 costs reflect only fiber. The Commission also acknowledged that there are additional costs associated with providing DS1 service over a DS3 facility that are not captured in the DS3 price.⁶⁴

For these reasons and others, the Commission has correctly ruled that "imposing such requirements on LECs while

⁶⁴ GTE Waiver Petition - Transport Pricing, para. 47.

their non-dominant competitors' rates are not similarly restricted could inhibit the full development of access competition, deny opportunities to consumers, lead to a waste of resources, and inhibit the full development of access competition, deny opportunities to consumers, lead to a waste of resources, and inhibit economic growth."⁶⁵ The Commission also noted that a required rate relationship between DS3 and DS1 services would discourage LECs from lowering DS3 and DS1 rates and "retard long distance price reductions, depress telecommunications usage, and ultimately restrict economic growth."⁶⁶

According to WilTel, "[t]he central objective [of regulation] should be pricing rules that recover common costs equally from all users in a market on a non-discriminatory basis. Unless the Commission adopts such pricing rules, LECs will have power to choose market winners and losers by pricing access to some services (including their own) to recover only incremental costs, while pricing other services at levels intended to recover all the shared costs of the network." (WilTel, p. 14.) For different customers to pay different shares of common and joint costs, WilTel claims, is "something the Communications Act cannot possibly permit for carriers that do not operate in a competitive marketplace." (Id., p. 29.)

⁶⁵ Transport Rate Structure and Pricing, CC Docket 91-213, released January 31, 1994, para. 15.

⁶⁶ Id.

WilTel's assertion is wrong as a matter of law. What WilTel advocates is indistinguishable in principle from fully distributed cost (FDC). For over a decade, it's been recognized that not only is FDC not required by the Act, it may be an abuse of discretion for the Commission to mandate since FDC "may effectively require the firm to forego price competition and gradually abandon market share, i.e., lose its business."⁶⁷ We submit that the "central objective of regulation" is to benefit the ultimate consumers of a product with lower prices and greater choices. That would certainly not occur if the Commission followed WilTel's suggestion, the primary purpose of which isn't to advance consumer interests but to protect intermediate players like WilTel who've benefited from non-cost-based pricing.

WilTel's factual premise is also wrong. If the marginal cost of fiber-based services is close to zero (WilTel, p. 28), what results is not unreasonable discrimination but the loss of market power as soon as another provider enters one of

⁶⁷ MCI v. AT&T, 708 F.2d at 1125.

our markets.⁶⁸ It's also disingenuous to suggest that we have the incentive to discriminate against WilTel because AT&T controls approximately 65% of total demand. (WilTel, p. 10.)⁶⁹ To be dependent on one customer for 65% of your demand is hardly an enviable position, as any former Pentagon contractor can attest. We have a legitimate long-term interest in remaining solvent. And what is relevant to our solvency isn't that AT&T accounts for 65% of our sales of certain products, but that AT&T

⁶⁸ It should not pass unnoticed that WilTel is vague and inconsistent about the cost characteristics of fiber. It refers at first to fiber's "minimal variable costs" (p. 13). It says later that "[t]he incremental cost of providing another unit of service ... is close to zero over today's networks. Even long run incremental cost is relatively low as a percentage of total cost" (p. 28). It's not clear whether the problem with fiber is its LRIC, or short-run incremental cost, or long-run marginal cost, or short-run marginal cost. These are all different things.

A number of tests have been proposed to distinguish between anticompetitive and consumer-welfare-maximizing pricing. Areeda and Turner propose a standard of short-run marginal cost, approximated in practice by average variable cost. Posner substitutes long-run marginal cost. Kahn also decided that in competitive situations long-run marginal cost would maximize consumer welfare, but considers long-run incremental cost to be a "more pragmatic" standard to apply. "It takes a firm's past history as given, does not assume that it is writing on a blank slate, but recognizes that it will ordinarily be planning the installation of new capacity, at whatever that additional investment will cost given its current situation, and it spreads the costs over either the total output of that additional capacity - in that sense it is a kind of average incremental cost - or over the additional output that is likely to be induced by a price reduction under consideration (or curtailed in response to a price increase." Affidavit of Alfred E. Kahn, "The Necessary Conditions of Effective Competition for Local Transport," CC Docket No. 91-141, August 6, 1991, p. 22 (filed with Pacific Bell's Comments). See also Kahn, The Economics of Regulation (Cambridge, 1988); and MCI v. AT&T, 708 F.2d, 1081, 1125 (7th Cir. 1983).

⁶⁹ We have no idea where WilTel got this figure, and believe it may be an overstatement. End users alone account for 40% of our hicap purchases.

has competitive choices and can take its 65% almost anywhere else it wants. One of those choices is WilTel. Competition from WilTel influences our prices to AT&T and everyone else whether or not AT&T buys WilTel's services. Nowhere in WilTel's Comments is it said that they compete with us. Yet it's the most important thing about WilTel's position.

The D.C. Circuit recently repeated its long-standing position in this debate. It made clear the Commission need not mandate the allocations that WilTel and others propose. When it reviewed the price cap rules in 1993 the Court said:

As the Commission plainly and explicitly recognized, deviations from fully distributed costs are in certain respects highly desirable and may tend to maximize the consumer welfare created by a regulated natural monopoly. While in a competitive market consumer welfare is maximized by marginal cost prices, that option is not realistically available for regulators of a natural monopoly. Because a natural monopolist is operating in a range where average costs are declining, and therefore where marginal costs are below average costs, marginal cost pricing would not permit the firm to recover its total costs. Thus the so-called "first best" efficient outcome is impossible, as its implementation would put the regulated firm out of business. As the Commission recognized, however, a regulator can realistically seek to achieve "second best" efficiency: the set of prices that allows the firm to recover its total costs while minimizing adverse effects on consumer surplus -- the difference between the price of a good and what consumers would be willing to pay for that good.

The orthodox concept of second best pricing is the inverse elasticity principle, or Ramsey pricing. The price increments over marginal cost are allocated in inverse proportion to the price elasticity of demand

for the good or service, with the increments relatively high for services for which demand is inelastic, low for those for which demand is elastic. The upshot is to ... maximize consumer surplus. As the Commission noted, a price cap regime is likely to induce companies to set Ramsey prices. Within the comparison group for which the price cap is defined (in the Commission's terms, within a "basket"), a firm can enhance its profits by increasing (as compared to fully distributed cost pricing) and proportion of shared costs borne by the inelastic services; the effect of the decrease in sales there will (up to a point) be more than offset by the effect of the increase in sales due to corresponding price decreases for the price-elastic service. The same price changes increase consumer surplus as well.

National Rural Telecom Ass'n v. Commission, 988 F.2d 175 (D.C. Cir. 1993). The Commission may well make rules that "disadvantage one class of ratepayers to the benefit of another class." 988 F.2d at 183. Indeed, Ramsey pricing may be a requirement of the Act if we remain a carrier of last resort and mandating some other form of pricing would threaten our long run solvency. See 708 F.2d at 1125.

The D.C. Circuit acknowledged that the Commission was "unwilling to embrace the efficiency goals of inverse elasticity pricing without limit ... [but was] concerned about possible unfairness to buyers whose demand was inelastic." Nonetheless, the Court found the Commission had balanced "efficiency goals with distributive concerns" by creating baskets and bands. 988 F.2d at 183. Our proposal would continue the use of baskets but would eliminate the price bands. The baskets in conjunction with the zones will effectively eliminate price shifts between

services that are not cross-elastic. That's all that's necessary to increase consumer welfare.

The Commission has shown itself increasingly willing to embrace pricing principles that advance the interests of customers as a whole. Thus, in its decision regarding the pricing of Basic Service Elements ("BSEs"), the Commission granted us pricing flexibility to set a BSE's price at different levels across its various uses according to relative demand and other factors.⁷⁰ The Commission noted that "legitimate reasons for rate variance include differences in demand patterns, population density, or network configuration."⁷¹

Cost standards that are based on mandatory allocation methods, no matter what they are called, introduce two basic distortions into decisionmaking that reduce consumer welfare. First, in the real world, economic decisions are based solely on the expected costs and revenues that will result from the decision at hand. A business decides to provide a new service or expand production of an existing service by comparing expected new costs to expected new revenues, without regard to

⁷⁰ Open Network Architecture Tariffs of Bell Operating Companies, 9 FCC Rcd. 440, para. 12 (1990).

⁷¹ Id. Zone density pricing was also a step forward, but a small one. We will not be able to lower prices for DS3 service in the highest density zone by more than 10% per year adjusted for the price cap index, without triggering the additional cost justification and advance notice requirements contained in the price cap rules. In addition, our DS1 and DS3 price movements will continue to be constrained by the 5% pricing bands around the existing DS1 and DS3 subindexes and by the 5% pricing bands around the Hicap service category of the special access basket. The zone density adjustments will have to be based on computer generated results of the interactions of three layers of price bands, all unrelated and unresponsive to market conditions.

costs it has already incurred or that need not be incurred until a different service is offered.

If a new service is a competitive one and its incremental cost is lower than your competitor's, customers will be better off both because they will get the new service at a lower price than before, and because the new service will contribute something to recovering the costs you have already incurred to provide other services. (It doesn't matter whether the existing services are monopoly services or not.) The purchasers of the existing services are better off than if you had not attempted to provide the new service. Any suggestion that profitable new services will contribute nothing to costs already incurred to provide existing services is absolutely false.

Second, all allocations are inherently arbitrary. As Alfred J. Kahn once observed, trying to allocate fixed costs that are common to several services in an efficient and fair manner is like trying to find a black cat in a dark room where there is no cat.⁷² William J. Baumol concurred: "No form of cost allocation can pretend to be compatible, generally, with efficiency in resource allocation, no matter how sophisticated its derivation."⁷³

If cost allocations are inherently arbitrary, one might ask, why is it not fairest to allocate them "uniformly"

⁷² Letter from Prof. Richard Schmalensee to Rep. John Dingell, dated Mar. 14, 1994.

⁷³ William J. Baumol, Superfairness (Cambridge, 1987), p. 146.

such as WilTel and others suggest? For one thing, because "uniform" is in the eye of the beholder. Any standard of "uniformity" (e.g., volume or investment) inherently handicaps one class of customers to the benefit of another. As Professor Schmalensee wrote,

It is not a matter of improving cost studies or methodology; costs that do not vary with the volume of service cannot be allocated on a cost-causative basis to individual services. Indeed, any allocation of fixed costs is necessarily arbitrary ... Shippers of diamonds, coal and feathers would prefer that the railroad allocate the fixed common costs of the railroad tracks on the basis of volume, value, and weight respectively, but none of these allocators is objectively better than the others. Since these fixed costs do not vary with the volume shipped, there is no objectively 'reasonable share of the joint and common costs of facilities' to allocate, and yet each party has a passionate stake in the outcome of the allocation.⁷⁴

Any mandatory allocation scheme prevents some decisions being made that would increase consumer welfare. WilTel's own history teaches that in the real world business decisions are and should be driven solely by incremental costs. We don't know if the following account (which may owe something to WilTel's highly effective advertising campaigns) is an accurate depiction of WilTel's history, but it accurately depicts the legend.

An oil and gas company from the Midwest was looking for ways to diversify and was in a

⁷⁴ Schmalensee, supra.

quandary with the Environmental Protection Agency (EPA).

It seems that the Williams Co., once heavy into transporting and pumping petroleum through thousands of miles of company-owned pipelines, found that due to certain external factors business had dried up. Long stretches of its pipes were lying dormant and the EPA was threatening to force the company to unearth and remove the cylinders that were the very arteries of its success. It was a disaster of megaproportions for the Tulsa, Oklahoma, company. It would not only lose its assets but the cost of digging trenches to extract the decommissioned pipes was staggering. The \$1.9 billion Williams Co. might as well have been digging its own grave if not for a brilliant idea by former pipeline executive Roy Wilkens....

The idea was to use the old pipelines as conduits for fiber-optic lines. If successful, the pipelines would once again be useful, the EPA would retract its order for pipeline removal and the Williams Co. would reinvent itself and proceed with its goal of diversifying. The Williams Co., now in the communications business, spun off Williams Telecommunications Co., or WilTel for short.

In 1986, an army of "pigs" marched across the continent to carry out its mission. Pigs are plastic balls just a little smaller than the diameter of the pipe. They were loaded into the pipelines not unlike the way balls are loaded into cannons. Sheaths of fiber-optic cables were attached to the tails of pigs. These pigs were then shot across the countryside in pipelines by high pressure air. Along the way the pigs squeeze out remnants of the old petroleum that once cruised these pipes. Just inches behind were lines of the new tenant taking up residence immediately. It was fast and easy, and cheaper than what newfound competitors were faced with.

WilTel, having owned the pipeline through its parent company, did not have to go through the expense of digging into the dirt 4 feet deep to bury its cable; it simply

"pigged" it into the pipe. And since the Williams Co. owned the rights of way of its existing routes, it did not have to deal with that, either.⁷⁵

We applaud this example of increasing consumer welfare even though, judged against the standard in WilTel's Comments in this proceeding, it was nakedly discriminatory. The greater part of the embedded costs of WilTel's fiber optic network were recovered from former (perhaps captive) pipeline customers who never used it. Yet it is intrinsically obvious that consumer welfare was increased by WilTel's decision. WilTel compared the expected (not historical) cost of the fiber network to expected revenues. Some other cost standard, for example one that allocated overheads uniformly (WilTel, p. 31), might have resulted in a decision not to build the network. The transport business would have been a little less competitive today. But in the real world, other cost standards aren't used to make business decisions.

MFS proposes a similarly inflexible cost standard. MFS proposes that "all trunking services would be compared to their underlying direct (long run incremental) costs. LECs would be allowed the flexibility to increase or decrease rates for individual rate elements as long as the price-to-cost ratio for each rate element remains within 10 percent of the average ratio for the basket." (MFS, p. 3.)

⁷⁵ Ray Santiago, "Inside the Superpipeline," Film/Tape World, May 1994 (vol. 7, no. 4), p. 16.

If a primary purpose of price cap regulation is to encourage us to behave as if we were operating as unregulated competitors in competitive markets, then prices should be determined for each service and for each market where the LEC provides those services. The price floor for each service would be its economic cost (i.e., the price below which it would cost more to produce than it would recover in revenues). MFS's proposal of a fixed (+/- 10%) price-to-cost ratio for all rate elements in all markets would prohibit us from competitively pricing to individual market conditions. This would lock in the anticompetitive effect of geographic averaging: we could at most optimize prices for a single service in a single market but the price of that service in other markets would be arbitrary.

WilTel and ICA make similar proposals. WilTel says that less competitive products should be tied to more competitive products, so that when a LEC lowers the price of a competitive product it must also lower the price of a less competitive product. (WilTel, p. 32.) ICA advocates a "price linking" mechanism for new services so that the API for new services would not vary more than 2% from the API for existing services. This would require us to decrease the price of a new service offering every time a cumulative price decrease of more than 2% was made for existing services. (ICA, p. 21.) These proposals would be completely inconsistent with pricing new services based on forward looking costs and demand, that is, on economic factors. Since new services will not have existed long enough to reap efficiency gains, new gains from advanced

technologies, or falling prices, it is unreasonable to expect the same decreases in rates for new services as established services that have been provided for years based on historical costs and old technology.

MCI, AT&T, and MFS urge the Commission to adopt "Total Service Long Run Incremental Cost" as the basic standard for reviewing our rates. (MFS, p. v; AT&T, p. 17; MCI, p. 55.) The Commission should be aware that there are differences of opinion about what TS-LRIC means. TS-LRIC is the difference in total costs to a firm between providing a service and not providing a service. It represents the minimum total revenue from all markets that the firm would require to offer the product. MCI and AT&T, however, would add an allocation of common costs or overheads to the TS-LRIC amount. This would, in essence, make TS-LRIC similar to FDC, with fixed service-wide costs allocated to particular overheads. The relevant test for cross-subsidization, however, is to compare the price of the service with the incremental cost of providing the service in that market.

TCG claims that "LECs' private line and Special Access services are priced below cost" (p. 5), and implies that this is due to the LEC's "tremendous market power." This represents either gross ignorance or intentional misrepresentation by TCG. The only below-cost private line and special access services that we know of are intrastate analog private line services, which don't appear to be what TCG is complaining about since it doesn't offer analog services. This was required over our

objections by state regulators, usually because such rates were lower than the direct embedded costs of providing those services. We and other LECs in California have been prevented by the CPUC from raising rates for these noncompetitive services to levels as high as direct embedded costs. To the extent that state regulators caused these analog private line service prices also to be below long run incremental costs, then these services were, by definition, being subsidized along with other such designated services (e.g., basic local service). The primary source for these subsidies were toll services (including switched carrier access). This pricing was clearly not a demonstration of market power. Rather it is an example of how regulators have required us to price our services without respect to economic cost.

WilTel complains that "LEC price cap baskets and bands do not significantly constrain LEC ability to offset price decreases for more competitive services with price increases for less competitive services" (p. 18). This isn't true. First, as we demonstrated in our comments, there's been a proliferation of bands and sub-bands that, if anything, goes much too far toward constraining our ability to price services on a rational basis -- that is, based on cost and demand. Second, as we discussed above (pp. 41-42), the D.C. Circuit reviewed this aspect of the price cap rules. It found that there was not only nothing wrong with the price shifts that WilTel complains of, but that, if anything, the Commission had put in place safeguards that were more than adequate to protect it. Third, if WilTel and others

were really concerned about anticompetitive price shifts, they would advocate, as we do, a combination of pure price cap regulation of less competitive services with pricing flexibility for competitive services. They don't, because their goal is protection, not competition.

ICI also seeks to be protected from LECs behaving as competitors. This is illustrated by its proposal that LECs "provide identically volume and term discounted rate structures (and levels) for functionally similar services" (ICI, p. 6) regardless of differences between different markets where the services are provided. This is a euphemism for geographic averaging. ICI also distorts Dr. Alfred Kahn's quote by erroneously equating AVC (average variable cost) with short run marginal costs. (ICI, p. 8.) AVC isn't a substitute for short run marginal cost.

MCI's position (see MCI, p. 75) departs from sound economics when it advocates measuring costs as if the network is being built from scratch. The costs that are induced by a business decision (including the costs involved in either introducing a new service or discontinuing an old service) are based upon expanding (or shrinking) the existing network, not in building an entirely new network to serve the services. In fact, to base costs on a hypothetical network should would produce costs closer to those of a new entrant, rather than the incumbent provider. To the extent that the incumbent can employ its economies in serving the volume in question, inappropriately measuring costs merely provides a price umbrella for inefficient

entrants, and ultimately harms consumers through the over-allocation of resources to this activity.

AT&T says we should have to establish a "low density index" for zones pricing with a 1% upward ceiling. (AT&T, p. 44.) This would be completely unreasonable. AT&T makes plain that its object is to "forestall interexchange rate deaveraging." (Id. at 45) It alludes to the Commission's "long-standing commitment to geographically average interexchange rates" (Id.), but fails to note that zone density pricing was a deliberate step away from geographic averaging, which the Commission took only when it determined that "[f]ailure to change the current system of uneconomic rate averaging would seriously constrain access competition and potentially deprive customers of the attendant benefits."⁷⁶

MFS (pp. 3, 17) proposes a form of rate element banding. MFS says the trunking basket's bands and subindexes should be replaced by a "cost consistency test" whereby individual rate elements could not vary by more than 10% of the basket's average price-to-cost ratio. The problem with rate element banding proposals, other than the Commission long ago considered and rejected them,⁷⁷ is the return to ROR regulation they would mark. They would further constrain us from pricing to cost, and help maintain the FDC-based price umbrella under which MFS and others have flourished at the expense of end

⁷⁶ Expanded Interconnection with Local Telephone Co. Facilities, 7 FCC Rcd. 7369, para. 184 (1992).

⁷⁷ Price Caps 2nd R&O, para. 222.

users. It would not only be administratively burdensome, but anticompetitive, for us to have to submit cost studies for all services, which MFS -- with tongue firmly in cheek -- suggests would be no more difficult than adding a column to the TRP chart. (MFS, p. 20, n.17.)

MFS also contends that new services should be included immediately in price cap indexes using forecasted demand. This would be internally inconsistent, since the price cap rules require calculations for all other services in the price cap indexes to be based on historical "base period demand."⁷⁸ Use of forecasted demand would likely place too much weight on new services. Historical demand would be inappropriately corrupted by forecasted demand.

IV. EXOGENOUS COSTS.

In our Comments we proposed that exogenous cost adjustments be limited to those resulting from Commission-approved changes in separations, cost allocations, or the Uniform System of Accounts. This is consistent with the fact that for price cap regulation to work, changes in inputs (for example, interest rate changes and short-term productivity results) must be treated endogenously whenever possible. Exogenous adjustments must be strictly construed or a return to cost-of-service ratemaking may result.

This dangerous tendency is amply demonstrated by AT&T's and MCI's proposals that the end of the equal access

⁷⁸ 47 CFR §§61.45, 61.46 and 61.47.

(EANR) amortization be treated as an exogenous change. MCI previously advocated this in a petition for reconsideration of the LEC Price Cap Order, and the Commission rejected it.⁷⁹ For the Commission to grant such requests would invite continued debate over what input costs should be individually reflected in rates, a debate that has the potential to degenerate into an old-fashioned rate case, with its attendant administrative burdens and loss of incentives to be efficient.

There also would be no simple or clear way for an EANR exogenous cost adjustment to be calculated. A reversal of the Commission's decision would raise difficult questions such as: whether the actual EANR amortization or the forecasted EANR levels underlying the initial price cap rates should be the basis of the adjustment; if actual costs, for what period (since the amortization changed each year); and to what degree the EANR amortization was affected by the other components of the price cap index. The Commission's observation regarding the difficulty of assessing equal access costs⁸⁰ is still correct.

The Commission has said that the July 1, 1990 rates provided "the most reasonable basis from which to launch" price cap regulation.⁸¹ This decision was based on the Commission's review of the LEC's total overall costs. Obviously some of our actual costs have varied from the forecasted levels in the July 1, 1990 start-up rates. MCI's and AT&T's approach implies the

⁷⁹ LEC Price Cap Recon. Order, para. 66, n.77.

⁸⁰ Price Cap 2nd R&O, para. 180.

⁸¹ Id. at para. 230.

need to selectively revisit, through lengthy and burdensome proceedings, the basis for our rates when price cap regulation began. That's not the nature of price cap regulation.

V. SERVICE QUALITY ISSUES.

The Tele-Communications Association (TCA) says "[t]o avoid creating a nation of urban 'haves' and rural 'have-nots,' and to ensure that the Commission and LECs themselves are aware of chronic problem areas and underserved locations, the monitoring reports should be revised in two respects: First, the LECs should be required to list in their quarterly reports any wire center that falls within the lowest ten percent of actual performance in any of several categories for three consecutive quarters. Second, the infrastructure development reports should be modified to provide for exception reporting of individual MSA or non-MSA areas that lag behind in deployment of key technologies. (TCA, pp. 7-8.)

This isn't the first time TCA has requested wire center level data for the service quality quarterly reports and similar data, MSA or non-MSA, for the infrastructure report. The Bureau has already considered and rejected this level of reporting, saying the "increased disaggregation of these data would place on the filing carriers and the Commission resources a burden that could not be justified."⁸² Further, it stated, "[w]e continue to believe, and data collected so far confirms,

⁸² Policy and Rules Concerning Rates for Dominant Carriers, 8 FCC Rcd. 7474, para. 12 (1993).

that the existing high level of service quality and the LECs responses to price cap incentives negate any need for disaggregated reporting or the establishment of national standards."⁸³ TCA has presented no new evidence to support any modification of this decision.

TCA's proposal suggests that for the infrastructure report, the LEC identify and report each MSA or non-MSA area falling in the lowest quartile in the deployment of four "key" technologies. "If an area appears on the list for more than four quarters, the LEC should be required to disclose its plans for deploying the technology needed to bring service up to par with the rest of its territory." (TCA, p. 8.) The flaw in this proposal is that, as with any ranking, something will always be in the lowest quartile (unless every element is ranked the same). Even though planned objectives were reached in a given area within a given time, it would still have to be reported as substandard because it fell in the lowest quartile. An item in the lowest quartile does not equate to a "chronically inferior service" or "chronic problem area" as TCA suggests.

The Commission promised in 1991 "to evaluate the actual effects of price cap regulation on service quality and network modernization."⁸⁴ The Commission's concern was that overall service quality should not deteriorate under price caps. TCA's proposal calls for a fundamentally different kind of

⁸³ Id.

⁸⁴ Policy and Rules Concerning Rates for Dominant Carriers, 6 FCC Rcd. 2974, para. 3 (1991).

reporting, where one carrier is compared with another. This would not fairly balance the need to monitor service quality and infrastructure development with the goal of minimizing the cost and administrative burden on the LECs. The Commission should reject TCA's proposal to expand the infrastructure monitoring report, as it has done before.

TCA also says that "expansion of the quarterly monitoring reports to include information on errored and severely errored seconds and availability is plainly warranted. If the Commission nonetheless has reservations about the feasibility of non-intrusive monitoring, TCA suggests that it require the LECs to disclose the extent of their deployment of extended superframe technology (which enables non-intrusive monitoring) and digital cross-connects." (TCA, p. 11.) As support for this conclusion TCA reports that "seven of ... fifty Pacific Bell respondents have established service quality standards with their LEC that include transmission parameters." (TCA, p. 11.)

We believe that customers interested in transmission parameters are interested only in the transmission rates that affect their own circuits. It is these customers who would have established quality standards with their LEC that include transmission parameters. These customers are not concerned about our overall network results. They only want us to meet the quality standards they have established for their circuits. Expanding the quarterly monitoring reports to include aggregated network transmission quality data would be useless to the

individual user, meaningless to the Commission, and costly for us.

Our network does support extended superframe (ESF) which as TCA indicates enables non-intrusive monitoring. Customers may use their own CPE to monitor their circuits, non-intrusively, to ensure that transmission quality standards established between the user and ourselves are being met. ESF does not, however, have the capability to aggregate data from individual customers. Indeed, if combined, the circuit data become meaningless.

TCA further suggests that as deployment of ESF is expand to "perhaps ten percent" of the data lines, "the LECs should be required to file quarterly transmission quality reports based on a random sample of their DS-1 and DS-3 lines." (TCA, p. 11.) Again, the customer decides whether to use ESF. The data is gathered by the customer and does not lend itself to aggregation for reports.

TCA also suggests that the Commission require LECs to report on the deployment of digital cross-connects and when this technology covers ten percent of the data lines, the LECs be required to report errored and severely errored seconds broken down by DS-1 and DS-3 service in each state. (TCA, p. 11.) First, circuits assigned to digital cross-connects are done without considering whether the circuit carries data or voice, only that the circuit is digital. Second, the first generation digital cross-connect systems don't have the network-wide data

aggregation and report generation capability that TCA's proposal would require.

To distinguish between circuit types, data versus voice, and to monitor the level at which digital cross-connects cover "perhaps ten percent" of the data circuits would require completely new and unnecessary monitoring and assignment processes. This would be onerous and administratively burdensome. Furthermore, the cost to develop the reporting capability in the digital cross-connect system far outweigh the benefits to the consumer, given that the capability exists in the CPE using the network's ESF technology. The Commission should also reject the suggestion that the deployment of digital cross-connects be monitored.

VI. COMPETITION IS GROWING IN THE LOCAL EXCHANGE. OUR PROPOSAL WILL ENHANCE IT, SAFELY AND FAIRLY.

In our Comments we showed that competition is growing rapidly in the local exchange. But it's growing unevenly, faster in some local exchange markets than in others. In four major metropolitan areas, we've already lost market power over transport services. In other markets, anticompetitive rules that keep our rates below costs have discouraged new entry.

We propose two ways to promote competition and consumer welfare in all parts of the new, uneven competitive landscape. The first is USTA's plan for market segmentation and flexible pricing in fully competitive markets. The premise of USTA's plan is that in competitive markets where customers have actual alternatives to using the LECs' services, full price

regulation harms consumer interests by keeping prices above cost. The second, complementary way is to regulate noncompetitive markets with price cap rules that stimulate investment, cap overall rates but permit service prices to move gradually toward costs, and to do away with ROR vestiges which reduce the ability and incentive to cross-subsidize.

Our competitors' comments may be summarized as follows:

A. Competition is scarce. The local bottleneck endures. We have 99% of the market for "access". (See, e.g., AT&T, p. 9; MCI, p. 65; TCG, p. 15.)

B. Numerous conditions, such as ubiquitous competition and basic network unbundling, must be satisfied before any streamlined regulation is permitted. (See, e.g., AT&T, pp. 16-21; MCI, pp. 67-72; TCG, p. 10; Time-Warner, p. 14.)

C. Continued asymmetrical regulation is needed to prevent discriminatory or anticompetitive pricing strategies. For example, prices should be determined according to fixed mathematical formulas, or based on costs that include allocations of joint and common costs or overheads. (See, e.g., MCI, p. 55; WilTel, pp. 31-32; MFS, pp. 17-20; CompTel, pp. 10, 14.)

Of necessity, this summary doesn't fully describe our competitors' arguments. They are overlapping and have complex subparts that we discuss in more detail below. The arguments have grown complex through long elaboration in numberless